

# governmental viewpoint

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Certified Public Accountants & Consultants

## Time is Running Out for Phase III GASB 34 Implementation

by Jerry Funk, CPA

Since its release in 1999, many governmental units have been dreading the day when they would be required to implement GASB Statement 34, especially the smaller units of government.



I believe many smaller governments covered under Phase III of the implementation schedule thought that the statement would be rescinded or would somehow not apply to them. The bad news is that after three years, the statement has not gone away and now the

implementation date for smaller governments is here or quickly approaching.

Phase III governments are defined as those whose revenues for governmental and enterprise funds in the fiscal year ending after June 15, 1999 were \$10 million or less. The effective date of the statement for Phase III governments is for fiscal years beginning after June 15, 2003. Therefore, if you have a June 30 year end, you are already in the fiscal year that needs to have GASB 34 financial statements.

As stated in previous issues, cash basis financial statements will continue to be an acceptable “other comprehensive basis of accounting.” However, even if your financial statements are prepared on a cash basis, these statements need to include all of the new GASB 34 components, including Management Discussion and Analysis (MD&A), Government Wide Financial Statements, Fund Financial Statements. Fixed assets and infrastructure need to be included in the financial statements also. To ease the burden of infrastructure reporting on Phase III governments, prospective reporting of infrastructure will be allowed. Many smaller governments without debt are planning to elect this prospective treatment for infrastructure. It should be emphasized that this prospective reporting is only available for infrastructure assets and not general fixed assets. All active fixed assets such as buildings, equipment and vehicles of the government need to be included in the financial statements regardless of when they were purchased.

The most challenging areas for the smaller governments will be the MD&A and the fixed asset reporting, assuming your government has not been keeping track of its fixed assets in the past. Governmental units that have implemented the new reporting model early highly recommend beginning the accumulation of data for fixed assets and information to be included in MD&A as soon as possible and not wait until the fiscal year of implementation is over. A number of examples of early implementer’s reports are included on the GASB web site [www.gasb.org](http://www.gasb.org). We are also available to discuss these implementation issues and answer any questions you may have.

Please feel free to call our offices or visit our web site at [www.lcvcpa.com](http://www.lcvcpa.com).

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## Fixed Asset Reporting—Where to begin if you never kept track

by Jerry Funk, CPA

A number of governmental units of all sizes are running into the same problem in the implementation of GASB 34—no historical capital/fixed asset records. It is important to remember that while the new reporting model allows for prospective reporting of infrastructure for Phase III governments, it does **not** allow for prospective reporting for fixed assets. Therefore, in the year your government implements GASB 34, fixed assets other than infrastructure need to be included in your financial statements. With that said, the question is where to start the process if your government has never maintained what used to be called the “General Fixed Asset Account Group.”

To begin, the definition of a capital asset is an asset that has a useful life extending beyond a single reporting period. Examples of such assets are buildings and improvements, machinery and equipment, land and land improvements, works of art, etc. The basis for valuing fixed assets in the financial statements has always been the historical cost for purchased/constructed fixed assets. For donated assets, the fair value of the asset as of the date of donation has always been the proper valuation method.

The first step in approaching the fixed asset dilemma is for the governmental unit to establish a capitalization policy. The policy would involve establishing a specific dollar amount for all assets that meet this definition and costs that exceed this dollar amount would be capitalized. GASB 34 does not prescribe a minimum level for the capitalization of assets, however, it does require the disclosure of the policy in the financial statements. The statement allows for different types of assets or classes of assets to have different capitalization policies. Most practitioners agree that by setting the capitalization policy at a **reasonable** level, this eliminates a large percentage of the small dollar items and the paperwork that goes with that tracking, while still accounting for 95% or more of the total costs by tracking the large assets.

Next, an inventory of fixed assets needs to be started of the items whose costs are expected to exceed the capitalization threshold. The inventory could be in any form, but a logical approach would be to create a data collection form to be used for each asset. Information that could be included on this



inventory sheet would be a description of the asset, the department or function the asset belongs, the actual or estimated purchase/construction date, and a section for the cost or estimated cost.

The next step is to assign a value to the item. Historical cost is the preferred method of valuing these assets and should be used whenever possible. In addition to finding the original invoice, historical costs could be obtained by reviewing board minutes of the year that the asset was purchased, old bond documents, engineering documents, audit reports, and capital project fund expenditures. To minimize the costs of implementation, GASB also allows for using deflated current replacement costs to represent estimated historical costs, if historical costs cannot be obtained. This method involves estimating the historical cost by calculating the current replacement cost of an asset and deflating this cost through the use of price-level indexes to the acquisition year (or estimated acquisition year if actual year is not known). It is important to remember that the amount of estimated fixed assets will need to be disclosed in the financial statements.

Once the purchase date and cost have been determined, the estimated life of the assets needs to be established. To determine an asset's useful life, consideration should be given to the asset's present condition, use of the asset, construction type, maintenance policy, and how long it is expected to meet service and technology demands. The lives should be based on the government's own experience and plans for the assets. The statement did not offer a recommended schedule of useful lives. The statement did mention, however, that depreciable lives for state and federal tax regulations are generally not intended to represent useful lives. Accumulated depreciation and depreciation expense for the year will be based on the remaining useful life.

If your government has not recorded its fixed assets in the past, you have some work to do. Hopefully this article has pointed out that with some planning and an early start, recording your fixed assets is not impossible. We are always available to discuss these implementation issues and answer any questions you may have.



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# What Are Internal Controls?

By Dan Rowe, CPA



## Definition

The integration of the activities, plans, policies, attitudes and efforts of people in an organization working together to provide reasonable assurance that the organization will achieve its objectives and mission. Managers (e.g., the governing board and operating management) are responsible for establishing an effective control environment in their organizations.

## Types of Internal Controls

- ◆ An organization's workforce that is effectively trained and managed.
- ◆ Key duties and responsibilities are divided among people to reduce the risk of error or fraud.
- ◆ Comparisons are made between budgeted and actual results and differences are analyzed.
- ◆ Physical control is established to secure and safeguard all vulnerable assets.
- ◆ Records are limited to authorized individuals.
- ◆ Transactions and other significant events are authorized and executed only by persons acting within the scope of their authority.
- ◆ Transactions are promptly recorded to maintain their relevance and value.
- ◆ A positive work environment is established in which high ethical standards are set.
- ◆ Internal control and accounting manuals are clearly documented and readily available for examination.

## Segregation of Duties

Segregation of duties, an arrangement of responsibilities where the work of one employee is checked by another, is hard to achieve with most governmental entities. In such cases, the activities should be segregated to the extent possible and alternative controls implemented to compensate for lack of segregation. One of the most important principles is to separate the following three functions: authorization of transactions, accounting for the transactions, and custody of the related assets. No one individual should be able to initiate a transaction and carry it through to its ultimate posting in the accounting system.

## Cost/Benefit Analysis

When weaknesses are found in specific controls, the organization has the choice of instituting new

controls, improving existing controls, or accepting the risk inherent in the weakness.

This is where management must identify and quantify the risk by looking at the probability and frequency of the error occurring. The magnitude of the error will also factor into the decision of whether extra controls are needed. For example, the opportunity for loss or error in over-the-counter cash may be greater than the risk of loss due to noncompliance with terms of a grant agreement. The magnitude of dollars, however, may indicate a greater dollar risk if the grant terms are not followed with than if over-the-counter cash is lost. The assessment of risk needs to be performed in determining the extent of controls needed.

## Internal Control over Cash

Internal control over cash (including cash in the bank) gets its own heading due to the susceptibility of cash and the fact that the majority of frauds that occur relate to cash. Cash is an important asset as most governmental entities both receive and make payments with cash. Features of good internal control over cash are:

- ◆ Preparation of control list of cash receipts when received.
- ◆ Cash receipts are deposited intact daily at bank.
- ◆ All payments are made by check other than petty cash payments.
- ◆ Accounting records are timely checked against the bank statement. An extra control would be someone outside of the accounting area checking the bank reconciliation.
- ◆ Separation of handling and recording of cash receipts and disbursements.
- ◆ Rotation of duties and mandatory vacations.

## Conclusion

Internal control is a process that needs to be continually monitored throughout the organization and modified when appropriate. The fact is, even the most perfect internal control system can be expected to provide only reasonable assurance, not absolute assurance, to an entity's management and board that no errors or irregularities have occurred.





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# INTERNET SITES

## Government-Related

## Surfin' for Fun

**[www.nasa.gov](http://www.nasa.gov)**

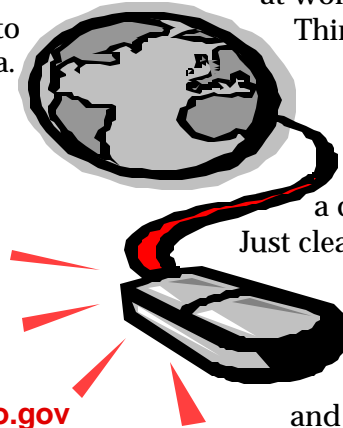
For kids, adults, educators. Wide variety from kids games and activities to the Horseshoe Keblula.

**[www.discoverfun.com](http://www.discoverfun.com)**

If you are bored, try this one. (not at work)...Also has 500 Fun Things to Do list.

**[www.nutrition.gov](http://www.nutrition.gov)**

Resource for all you eat or think about eating. Includes massive amounts of data and interesting fact sheets.



**[www.gcfl.net](http://www.gcfl.net)**

Ready for some Good Clean Fun for a change? Here's the site. Just clean jokes—thousands of them.

**<http://bensguide.gpo.gov>**

An animated Ben Franklin is your teacher, helping students K-12 on all kinds of important facts. Also a separate section for parents and teachers.

**[www.threestooges.com](http://www.threestooges.com)**

Everyone knows Moe and Larry, but what are the names of the non-Curly members of this incredible trio? And when? Find out here.

## Viewpoint Views

### Various Items of Interest from LCV

#### Revision of OMB Circular No. A-133

The Office of Management and Budget (OMB) is issuing final revisions to Circular A-133, "Audits of States, Local Governments, and Non-Profit Organizations." The main revision that will affect local governments is the increase in the threshold for single audits. The revision raises the threshold from \$300,000 to \$500,000 in expenditures. The OMB estimates that this increase will relieve almost 6,000 entities from the audit requirements while only exempting less than one half of one percent of Federal awards expended from audit. The final revisions are effective for fiscal years ending after December 31, 2003. Early implementation will not be permitted.

#### HB 765

HB 765 was recently signed into law by the Governor effective July 28, 2003. The bill provides a two year window (from July 1, 2003 to June 30, 2005) for a school board to transfer funds among the Education Fund, the Operations and Maintenance Fund, and the Transportation Fund for any purpose (not just to meet one-time, non-recurring expenses and not just to the fund most in need).